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SUBJECT: AUSTRIAN AIRLINES LOOKING FOR STRATEGIC PARTNER

REFS: A) VIENNA 675 B) VIENNA 395

Summary

1. Austrian Airlines (AUA) is now officially considering a strategic partnership in an effort to shore up its worsening financial position. This turnaround stems from the decision by Saudi investor Sheik Mohamed Bin Issa Al Jaber to back out of his planned investment in AUA. Lufthansa and Aeroflot have publicly stated their interest in AUA, but AUA is privately considering other partnership possibilities, as well as a stand-alone option. A strategy to engage in a strategic partnership will require a political decision by the GoA, as its holding company holds a 42.7% share in the national carrier. While senior politicians have been ambiguous as to their intentions, time is running out, as AUA now forecasts a loss of up to Euro 90 million in 2008. End Summary.

AUA Looking for Strategic Partner

2. In an effort to overcome mounting financial problems, an Austrian Airlines (AUA) Supervisory Board meeting on June 9 decided to explore the possibility of accepting a strategic partner. The GoA's holding company and the majority owner of AUA, the OIAG, convened the extraordinary meeting following the decision of Saudi investor Sheik Mohamed Bin Issa Al Jaber to back out of a planned investment in AUA. OIAG has hired the Boston Consulting Group (BCG), which will produce an interim report by the end of July and a detailed recommendation for a strategic partner by the end of September.

3. Lufthansa has signaled its interest in AUA. On June 16, Lufthansa CEO Wolfgang Mayrhuber confirmed that AUA would fit into Lufthansa's strategic plans, but he noted that Lufthansa would not be satisfied with a minority share in AUA. The only other carrier to publicly announce its interest in AUA is Aeroflot. Aeroflot's CEO, Valeri Okulov, said the Russian company is waiting for an offer from the GoA to enter into negotiations. Another prospective suitor, Emirates Airlines, acknowledged that it would like closer cooperation with AUA, but excluded a formal alliance or investment.

4. AUA International Director Walter Reimann told EconUnit Chief on June 18 that there were additional partnership possibilities, which have not been made public. According to Reimann, BCG would also consider the pros and cons of AUA continuing as a stand-alone carrier. Reimann conceded that to survive as an independent carrier, AUA would have to engage in a major cost-cutting program. In such a scenario, AUA would maintain its strong presence in

Eastern Europe, while scaling back on its overseas routes.

2008 Forecast Revised Downwards

15. Citing higher fuel costs totaling approximately Euro 130 million, AUA announced that it had revised downwards its 2008 forecast to a loss of Euro 70-90 million. However, higher fuel prices are only one factor contributing to AUA's financial woes. Its financial problems started with the politically motivated takeover of financially troubled Lauda Air in 1997 (since 2000 a 100% subsidiary of AUA), including Lauda Air's debts. AUA's costly two-fleet strategy (Airbus and Boeing) is also a legacy of the Lauda Air takeover. AUA is also booking fewer business-class passengers, who are increasingly turning to private jet rentals.

Comment

16. Media reports focus on Lufthansa as the logical and ideal partner for AUA. However, some experts point to Lufthansa's apparent interest in competing with AUA's extensive network in Central and Eastern Europe and Southeastern Europe (CEE/SEE) from its Munich hub. A political decision must be made to move forward with a strategic partner, as OIAG holds a 42.7% share in AUA. Comments from senior GoA officials have been ambiguous as to the government's intention. In a delicate grand coalition, both parties are weighing the possible political fallout from a strategic partnership. However, with quarterly losses mounting, there may not be much time remaining to deliberate AUA's fate.

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